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Business Basics

Consumer Credit

A Self-Instructional Booklet
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GUIDESHEET

CONSUMER CREDIT - RETAIL STORES

INTRODUCTION

This booklet is part of a series intended to help small businesspeople increase their knowledge of, and skills in, various aspects of business management. Other booklets in the series may be obtained from the nearest Small Business Administration field office.

Consumer Credit - Retail Stores discusses the ways a retail store can handle the issuance of consumer credit and the collection of payments. It covers the following topics:

- credit cards
- direct credit
- business implications of granting credit
- credit policy
- evaluation of credit
- avoiding losses
- collection procedures

As a result of completing this booklet, the small businessperson should:

1. Be able to determine whether either or both of the two primary types of credit plans are appropriate for his or her business.

2. Be more aware of ways that credit may affect the business.

3. Be able to set up methods for evaluating consumer credit status, and implement procedures for issuing credit.

4. Be more able to avoid losses through careful record keeping and collection procedures.

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COLLECTION PROCEDURE

John Perkins, who owns a small appliance store, was upset one day when he saw that money tied up in credit to customers had increased considerably during the past month and that a lot of his time was needed to collect from those who were slow in paying. "I thought that giving credit to people who looked like they could pay would bring me more business," he said. "But I am beginning to wonder whether a lot of these people will ever pay back the money I lent them through the store. Am I doing the right thing or should I stop selling merchandise on credit?"

In another part of town, a clothing retailer was complaining that people never want to buy with money any more. "In fact, many customers have walked right out of my store when I tell them I don't accept credit cards. They say, why should I pay cash to you when I can go elsewhere and buy all I want on credit?"

These two situations dramatize the subject covered in this study unit on how to handle consumer credit.

OVERVIEW AND PURPOSE

This particular booklet should help you to:

1. Gain a better understanding of credit policy and the different types of credit plans through:

   - o credit card systems
   - o granting direct credit

2. Evaluate what type of credit policy and what type of credit plans, if any, would be most appropriate for your business.

3. Review methods for evaluating consumer credit status, and policies and procedures for issuing credit.

4. Increase your skills in avoiding losses in consumer credit and in evaluating your own credit policy.

FORMAT

The information in this booklet is presented in a unique way. For example, following each key thought will be a question or series of questions to which you will be asked to respond. These questions will require you to restate the key points described in the paragraphs immediately preceding the question. In each case, you should write a few notes on how you would respond to the question directly on the page in the space provided so you will have it as a permanent record for review. NO NEED TO WRITE COMPLETE SENTENCES - just a few words to indicate your thoughts. A good answer to each question will be given in the box on the first even numbered page which follows the question. Your answers need not match the booklet answers exactly.

It will, of course, do you little good to look ahead at the answers before writing out your own. The whole purpose of this type of learning format is to give you a chance to see whether you clearly understand and remember the information by writing it out before you check the answer.

In addition to the questions, you will be asked to work on several on-the-job activities. These will be brief suggested assignments which will give you a chance to apply one or several of the concepts discussed in the booklet to actual work situations in your own firm. If possible, you should discuss these assignments with someone whom you consider knowledgeable in personnel work so you can benefit from any ideas which come up.

It is important to note here that this booklet is not intended to provide you with exhaustive information on this topic. Nor is it designed to tell you how to run your business. Rather, the booklet is intended only to increase your knowledge and skills by reviewing some basic practices that are appropriate for use in small firms. They can easily be modified to best serve the needs of your own firm.

INTRODUCTION

Consumer credit has always been very important to retail businesses.

If you are trying to decide whether you should offer credit to customers, or if you are thinking about cutting back, or stopping credit, you should ask yourself the following questions:

1. How much credit shall I grant, if any?
2. To whom shall I (or shall I continue to) grant credit?
3. For how long shall I grant the credit?
4. What impact will granting of credit have on cash flow and on working capital I need?
5. What is (will be) the cost in expenses and effort to grant credit?
6. What method shall I use for granting credit?
7. When payment is not being made promptly, what steps shall I take to collect?

In addition to these questions, it is also important to check, from time to time, whether credit does indeed bring the benefits it is expected to bring. If problems exist, you must decide what can be done to improve the credit operation so that it will bring higher gross profit at lower cost.

1. *What are 6 questions which should be resolved before granting credit?*

   Your Answer: (Remember, in this question, as well as in future ones, there is no need to write complete sentences - just key words on how you are answering the question. A good answer is on page 4.)

TYPES OF CREDIT PLANS

In a retail establishment you can grant credit primarily on the basis of two possible systems:

1. You can honor one or several established credit cards.
2. You can allow customers to open accounts with you and grant them credit directly.

Book Answer

1. *The six questions which must be resolved before granting credit are:*

   - *How much credit shall I grant, if any?*
   - *To whom should I grant credit?*
   - *For how long shall I grant the credit?*
   - *What method shall I use for granting credit?*
   - *When payment is not being made promptly, what steps shall I take to collect?*
   - *What will be the impact on cash flow and on working capital required?*

CREDIT CARDS

In granting credit on the basis of credit cards, you have many choices. You can honor:

- one or more of the major bank credit card systems
- travel and entertainment cards
- one or several of the major oil company credit cards if you are in an automobile related business

Which card(s) you honor and how many you offer depends on the needs of your business. It is important to remember though, that the more cards you honor, the more paper work you create for yourself and the more complex the credit authorization procedure becomes when someone wants to make a fairly large purchase on one of these credit cards.

Credit granted with credit cards does not require many complex decisions from you except for the initial decision to work with a particular credit card issuer. At this point you may be able to negotiate the charge, usually called a discount, which the issuer will deduct from your credit slips for the service of paying you before the money can be collected from the customer. Since credit card companies assume much of the responsibility for collecting payment from the customer their fee of 3% to 6% of the amount purchased is usually well worth not having the collection problems and paper work yourself.

Along with the discount rates, the credit card company establishes a store's authorization line. The authorization line is the maximum amount which a store may allow a customer to charge to a card, without store personnel having to call the credit card company for approval.

Thus, when a customer wishes to make a purchase on a credit card, the usual procedure is to first check to assure yourself that the credit card has not been listed on the latest list of withdrawn cards. If the card has not been withdrawn, and the purchase amount does not exceed the store's authorization line, the sale may be charged to the card. However, if the amount the customer wishes to purchase exceeds the stores authorization line, then a call must be made to the credit card company in order to gain approval for the sale. At this time, the credit card company checks the customer's balance and decides whether or not to allow the customer credit for the purchase. If the customer's credit standing is good, the credit card company will allow the store to accept the customer's credit, and will give the store an authorization number for the sale.

Obviously, if the customer has a withdrawn card, or if the customer wishes to purchase on credit more than the credit company is willing to lend the customer, then the store is not authorized to transact the sale through credit. Should a store fail to obtain an authorization number for a large credit card purchase, then the store rather than the credit card company, must bear the loss should the customer fail to pay. The store is also responsible for checking that the customer's signature on the slip matches the one on the credit card itself.

In many areas of the country today, merchants who make many sales on credit and who most frequently check customer credit, install a small direct access computer terminal in their store. The amount to be purchased is then typed on the terminal, and the computer checks whether the card has been withdrawn, and checks the credit company's files to determine whether the customer has enough credit to cover the purchase.

2. *What is an authorization line?*

Your Answer:

READEX FICHE

Book Answer

2. *An authorization line is the maximum amount which a store may allow a customer to charge to a credit card without having to call the credit card company for approval. Purchases beyond this amount have to be authorized by the credit card company before the sale can be charged to the card.*

Direct Credit

You may feel that your business would benefit from granting credit directly. Some credit customers are often more loyal than cash customers. Sales and income may benefit from such a move. As will be discussed later, such a move might bring higher or lower costs. Your cash flow and the working capital required for your business would both be affected.

If you decide to grant credit directly, there are two ways you can do so:

1. For individual purchases - this means that a separate bill will be submitted for each purchase and full payment against that bill is expected within the normal credit period, whether it be 10 days, 25 days, 30 days, or even longer. As long as payment is received within the normal credit period, no finance charge is made to the customer.

2. On a revolving credit basis - in this method, a separate bill is submitted for each purchase and a minimum partial payment against that bill is expected within the normal credit period. The customer must also pay finance charges each credit period, based on the unpaid balance of his or her bill.

In addition to granting credit, many businesses cash checks for customers. While this is not directly a form of credit, it can become credit if the check is not covered and is rejected by the bank. For this reason, most retailers place restrictions on the type of checks they will cash. They will usually cash checks only up to a maximum limit which they consider safe, and will cash them only for people they know or who show them detailed identification. It is becoming more and more common to ask check writers for both a driver's license and an established credit card. Few retailers will accept out-of-state checks (because they are much more difficult to collect if they bounce) and few will cash checks in excess of the amount required for a purchase.

3. *What alternatives does a retailer have in deciding whether or not to offer credit cards?*

Your Answer:

4. *What are 2 major ways a retailer can grant direct credit?*

Your Answer:

BUSINESS IMPLICATIONS OF GRANTING CREDIT

Credit cards and direct credit affect the two closely related vital financial factors, cash flow and working capital, though they have widely different impact.

Cash Flow

When you receive immediate payment for merchandise your sales and your collections are identical. If you grant credit, either through a credit card or directly, you will, at first, receive less payments than the sales value of the merchandise you have sold. This is especially true in the first year but also occurs whenever you increase the amount of credit you grant to your customers, or when you extend it for a longer time. Whether and how much you will reduce your cash receipts depends, of course, on the terms of credit and to what extent credit will increase your sales.

For those customers who pay their bills in full once a month, there will merely be a delay of one month. For those who pay in installments, however, the delay can be significantly longer.

Working Capital

Credit sales are the same as loans; you must have the money to pay your costs on these sales. When credit sales are large, this means that capital is tied up in credit and cannot be used for purchase of inventory or other business purposes. This is discussed in greater detail later on in this booklet.

Book Answer

3. *The major alternatives the retailer has to offering credit cards are:*

   - *the retailer may grant direct credit*
   - *depending on the type of business, and the amount of volume which competitors do on credit, the retailer may wish to offer no credit at all if little need exists for it*

Book Answer

4. *The two major ways a retailer can grant direct credit are:*

   - *For individual purchases - this means that a separate bill will be submitted for each purchase and full payment against that bill is expected within the normal credit period. As long as payment is received within this normal credit period, no finance charge is made to the customer.*
   - *On a revolving credit basis - in this method a separate bill is submitted once a month and the minimum partial payment against that bill is expected within the normal credit period (usually 30 days). The customer must also pay finance charges for each credit period based on the unpaid balance of his or her bill.*

CREDIT POLICY

There are two extreme ways to look at credit if you grant credit directly. One is not to grant credit to anyone, and the other is to grant customers all the credit they want. Neither extreme is, of course, wise. There is, however, a wide range of possible credit policies which deserve consideration. The range stretches from liberal extension of credit with a liberal collection policy to strict extension of credit with strictly enforced collection dates.

A liberal credit policy involves the granting of credit to people without extensive checking to see whether they will be able to make payments. In a strict credit policy, a customer's financial background is checked thoroughly, before credit is granted.

Collection policies, on the other hand, refers to method of repayment. A liberal collection policy allows extensions of repayments to later dates, whereas a strict collection policy demands that payments be made right on schedule.

What combination to choose depends a great deal upon the type of business you are in. If you are a travel agent, for instance, who has to pay the airlines and steamship companies promptly, and are involved with large sums and small profit margins, you cannot afford to extend credit liberally. You must extend credit only to people who can convince you that they will pay promptly. On the other hand, if you are extending credit for a highly profitable low cost item, you can afford to be much more liberal.

How liberal your credit policy should be, also depends on the policies of your competitors and the extent to which your business depends on credit for the volume you need to be profitable. It also depends on your ability to handle credit - financially and in the time you have available for collection work.

5. *What are some of the considerations that affect how liberal your credit and collection policy should be?*

   Your Answer:

6. *What distinguishes a liberal credit policy from a strict credit policy?*

   Your Answer:

7. *What distinguishes a liberal collection policy from a strict collection policy?*

   Your Answer:

Book Answer

5. *Some of the considerations that effect how liberal your credit and collection policy should be are:*

   - *the type of business you are in and whether you are extending credit for a highly profitable low cost item or a less profitable high cost item*
   - *the credit and collection policies of your competitors.*
   - *the extent to which your business depends on credit for the volume you need to be profitable*

Book Answer

6. *A liberal credit policy involves the granting of credit to people without extensive checking whether they will be able to make payments. A strict credit policy is one in which you extend credit only to people who can convince you that they will make payments promptly.*

Book Answer

7. *A liberal collection policy allows extensions of repayments to later dates, or of smaller amounts while a strict credit policy follows up quickly to demand payments that have not been made on schedule.*

EVALUATION OF CREDIT

In evaluating the benefits and costs of granting credit you have to look at both sides: the benefits which the credit brings you, and the costs.

The benefits are chiefly the extra business you obtain because you grant credit. If all competitors are conveniently located and they grant credit, you can assume that you would lose a large proportion of the business that is now transacted on credit, if you had a no-credit policy. On the other hand, if only a relatively small proportion of your business is credit business, then you gain relatively little benefit from offering credit.

How much benefit you derive from offering credit is a judgement that you have to make based on the conditions in your business.

A simple formula with which you can calculate the benefits which credit brings is as follows:

$$\left(\begin{array}{l}\text{the amount of}\\ \text{business which}\\ \text{you think credit}\\ \text{alone brings}\end{array}\right) \times \left(\begin{array}{l}\text{the percent}\\ \text{net profit you}\\ \text{made on that}\\ \text{business}\end{array}\right) - \left(\begin{array}{l}\text{costs of}\\ \text{providing}\\ \text{credit}\end{array}\right) = \left(\begin{array}{l}\text{Benefit - the}\\ \text{net profit}\\ \text{which credit}\\ \text{brings}\end{array}\right)$$

It is a much easier process to evaluate the costs of credit. If you are doing business with a bank credit card or other established credit card, you can easily calculate how much you pay in discounts to the credit card issuer and how much the telephone calls and other processing costs amount to. These costs can then be compared with the benefits which credit brings in additional sales.

In order to figure the costs of providing credit (if you are providing credit directly) you have to add:

- the costs of billing customers, including costs of mailing statements and costs that your data processing organization or wholesaler charges for services
- cost of credit checks or reference checks

- the costs of credit losses
- the cost of money tied up in credit

EXAMPLE: Determining the Benefit Which Credit Brings

Assume that:

- during the course of a year you find that you are doing $50,000 worth of business on credit
- on reviewing this business, it appears to you as though only $10,000 of the business would be obtained if you did not grant credit. Therefore $40,000 of your business is a result of the credit you extend.
- you have a net profit of 20% on your business

Your costs may be as follows:

Annual cost of billing customers and other paperwork connected with credit	$ 600
Cost of credit reference checks	$ 150
Bad-debt losses	$1,200
Cost of money tied up in credit (10% of the average $4,000 monthly credit balance)	$ 400
Total Costs	$2,350

In this example your total benefits from granting credit can easily be obtained by using the simple formula on page 11.

($40,000 of business probably brought in by credit alone) X (20% net profit on business)

\- $2,350 cost of providing credit

(=) benefit: $5,650 net profit which credit brings you

If you find it easier to work with a step-by-step procedure, the same example can be worked out on a form like the one below:

BENEFIT FROM CREDIT

A simple form which you may use in calculating the benefits derived from credit is given below:

1.	How much business, in dollars, did you do on credit last year?	$50,000
2.	Review this business and determine how much of the business you would have obtained if you did not grant credit.	$10,000
3.	Line 1 - Line 2 (indicates the amount of your business which was a direct result of the credit you extended).	$40,000
4.	Line 3 x the % net profit you make ($40,000 x .20).	$ 8,000
5.	What is your annual cost of billing customers and of keeping the credit records?.	$ 600
6.	What is the cost of credit reference checks, e.g., credit bureaus, etc.?	$ 150
7.	How much did you lose in debts which customers never paid?	$1,200
8.	What is the cost of money you have tied up in credit?	$ 400
9.	Total cost of granting direct credit (add together lines 5 through 8 and total)	$2,350
10.	Benefit in net profit, which credit brings you (Line 4 - Line 9)	$5,650

An analysis like this can give you an idea of how much you benefit from the direct credit you grant to customers.

Note that granting credit, in this example, requires that you invest $4000 in credit to your customers. This $4000 has to be available. If you cannot obtain it, it will hurt your ability to carry adequate stock.

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A similar analysis can be made when you use credit cards.

In the example above, granting credit and the way it was being granted appeared to be profitable. It is,of course, worthwhile to compare this with alternate ways of granting credit. For instance, you could use credit cards and, on the assumption that the credit card company would charge a 5% discount, the calculations might look as follows:

Discount on credit card charges (5% x $50,000) = $2,500

Cost of checking larger purchases
(phone calls and time spent calling): = $500

Total costs: $3,000

Comparing this cost with the cost of direct credit shows that direct credit brings in $650 more profit than credit cards - for this particular retailer. (Credit cards cost $3000 annually as compared to $2350 for direct credit.)

Still another way to revise and possibly save on granting of credit would be to make more detailed checks on credit risks. This could be based on a very detailed study of the characteristics of people on whom losses have been encountered in the past. This would result in a somewhat tighter policy, which may be the least expensive way to operate the business. A tight credit policy would, of course, result in somewhat less business, but then it takes $5.00 of sales to make up for every dollar of credit lost, in the example shown above. ($1.00 lost ÷ .20 net profit margin = $5.00 of sales)

All these estimates are, of course, difficult to make. Nevertheless, an attempt to make reasonable estimates can give you a lot of information about the impact which credit is likely to have on your business.

8. *Assume that a certain retailer (a different one than the one in the previous example) does $40,000 of business annually on direct credit which is granted through the store. A review seems to indicate that only $15,000 worth of business would be obtained if credit were not granted. Also, assume that the retailer has a 15% net profit margin.*

   The retailer's costs of providing direct credit are:

Annual cost of billing customers	*$1,000*
Cost of credit reference checks.	*$ 200*
Bad debt losses (and lawyer's fees).	*$2,500*
Cost of money tied up in credit.	*$ 333*

   1. *How much benefit does this retailer derive from granting direct credit? (You may wish to use the credit formula on page 11 or the credit sheet presented on page 13 to help you in these calculations.)*

   2. *Would the retailer have been better off honoring credit cards at a 5% discount, rather than granting direct credit? (Assume that the cost of checking large purchases would have amounted to $300.)*

   Your Answer:

9. *In the business presented in problem 8 how much in sales does it require to make up for every dollar of bad debt?*

   Your Answer:

Book Answer

8. One simple way of calculating the benefits derived from direct credit (using the form from page 13)is:

1.	How much business, in dollars, did you do on credit last year?	$40,000
2.	Review this business and determine how much of the business you would have obtained if you did not grant credit. . . .	$15,000
3.	Line 1 - Line 2 (indicates the amount of your business which was a direct result of the credit you extended). . . .	$25,000
4.	Line 3 x the % net profit you make. . . .	$ 3,750
5.	What is your annual cost of billing customers?.	$ 1,000
6.	What is the cost of credit reference checks, e.g., credit bureaus, etc.? . . .	$ 200
7.	How much did you loce in debts which customers never paid?	$ 2,500
8.	What is the cost of money you have tied up in credit?.	$ 333
9.	Total cost of granting direct credit (Add together lines 5 through 8 and total)	$ 4,033
10.	Benefit credit brings (Line 4 - Line 9) .	$ 283

Book Answer

9. Obviously in this situation something has to be done to reduce bad debts before it is worthwhile for this retailer to continue granting credit.

It would take $\frac{\$2,500 \text{ in bad debts}}{.15 \text{ profit \%}}$ or $16,666 in sales to make up the $2,500 in bad debts lost annually in credit operations. This is equivalent to $4.00 of sales needed to compensate every dollar lost in bad credit.

10. In problem 8, would the retailer have been better off honoring credit cards at a 5% discount, rather than granting direct credit? (Assume the cost of checking large purchases would have amounted to $300.)

Your Answer:

ON-THE-JOB ACTIVITY 1

1. In your business, how much in sales does it require to make up for every dollar of credit lost?

2. What, in your business, do you estimate to be the cost of communicating with the credit card organization if you were to use credit cards, or if you do use them?

3. If you already grant direct credit, estimate the benefit it brings you by using the formula on page 11 or the step-by step form on page 13.

If possible, discuss your thoughts with a person whose opinion you respect and see what additional ideas come from such a discussion.

Book Answer

10. Business done on credit: $40,000

Discount on credit card changes (.05 x $40,000): . $ 2,000

Cost of checking large purchases . . . . . $ 300

Total cost of honoring credit cards. . . . . $ 2,300

Since the total cost of granting direct credit amounts to $4,033, the retailer would have higher net profit by honoring credit cards rather than by granting direct credit.

CREDIT POLICIES AND PROCEDURES

Obtaining Information

Before you decide to grant direct credit to a customer, you will probably want to know something about that person. Specifically, you will want to know what your chances are of getting paid for merchandise which you sell this customer on credit. On the one hand, if you have known the customer for a long time, and know something about his or her background, you may need to do very little checking into the customer's credit status. On the other hand, if you have questions about the customer's credit worthiness or ability to pay, you will probably want to make a thorough check into the customer's background.

In either case, you will need some kind of a form which you can ask the customer to fill out in order to obtain the information you need. Such credit forms are often adapted from some standard credit form or may be obtained from an organization with which you work.

In many industries, wholesalers who have their own computer facilities or make extensive use of computer services, very often offer collection services to their retailers and can provide charge account application forms. Other places where you may obtain charge

account application forms include credit bureaus* that the retailer may use to check credit of doubtful applicants for you, or a data processing organization who bills for you.

No matter what application is used, it is likely to ask the following information of the applicant:

- o current address (and previous address if they have lived at their current address less than a minimum number of years)
- o current position (and applicant's previous position if the time spent in the current position is relatively short)
- o salary and other income
- o rent or mortgage payments and whether the applicant rents or owns
- o major financial obligations
- o credit references usually including at least one bank, and one other credit line, either credit card or other charge account
- o number of dependents

Applications are subject to equal credit laws. Therefore, to assure that you do not violate these laws, it is useful to review applications with the bank with whom you do business or with somebody who is knowledgeable in credit applications. Furthermore, since most retailers levy a finance charge for unpaid balances beyond a certain amount of time, information about these finance charges must be provided in detail on the application form.

On page 20 is a sample credit application form which a certain wholesaler makes available to retailers.

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*If you have never used a credit bureau, you could obtain the names of several local ones from the telephone book's yellow pages and interview them to see the services they offer and their fees. Credit bureaus' charges and services vary widely and careful selection of the best bureau can save a lot of money.

CHARGE ACCOUNT APPLICATION

Name and address in which account is to be carried. Courtesy titles optional ☐ Mr. ☐ Mrs. ☐ Miss ☐ Other _____

(PLEASE PRINT) FIRST NAME	MIDDLE INITIAL	LAST NAME	PHONE NO.
ADDRESS	CITY	STATE	ZIP

IF APPLICANT'S SPOUSE IS AUTHORIZED TO USE THE ACCOUNT, PRINT NAME HERE

IF OTHERS ARE AUTHORIZED TO USE THE ACCOUNT, PRINT NAMES HERE
1. 2.

SOCIAL SECURITY NUMBER	NUMBER OF DEPENDENTS	AGE	HOW LONG AT PRESENT ADDRESS	☐ OWN ☐ RENT ☐ BOARD	MONTHLY RENT OR MORTGAGE PAYMENTS

FORMER ADDRESS (IF LESS THAN 2 YEARS AT PRESENT ADDRESS)	HOW LONG	EMPLOYER

ADDRESS CITY STATE ZIP	HOW LONG	OCCUPATION	ANNUAL SALARY

FORMER EMPLOYER (IF LESS THAN TWO YEARS WITH PRESENT EMPLOYER	HOW LONG

OTHER INCOME IF ANY AMOUNT$	NOTE: Income from alimony child support or separate maintenance payments need not be disclosed unless relied on as a basis for credit	SOURCE OF OTHER INCOME

CREDIT REFERENCES

NAME OF BANK	ADDRESS CITY	BANK ACCOUNT	☐ SAVINGS ☐ CHECKING	☐ LOAN
NAME OF BANK	ADDRESS CITY	BANK ACCOUNT	☐ SAVINGS ☐ CHECKING	☐ LOAN

OTHER ACCOUNTS

CREDITOR (NAME AND ADDRESS)	ACCOUNT NUMBER	NAME IN WHICH ACCOUNT IS CARRIED	BALANCE	MONTHLY PAYMENT

RETAIL INSTALLMENT CREDIT AGREEMENT

The undersigned customer ("Buyer") hereby agrees with the Store identified below ("Seller") that all purchases of goods and services under buyer's charge account with Seller ("Account") shall be subject to the following terms:

1. Buyer agrees to pay in full all purchases charged to the account and all other amounts, including finance charges, due under this agreement. All charges will be billed on a monthly basis and are due and payable upon receipt of the billing statement. Each billing statement will include all charges and payments and other credits received during the monthly billing period ending on the billing date shown on the statement.
2. In order for Buyer to avoid a **FINANCE CHARGE**, payment for every charge, including finance charge, must be received by Seller within month(s) after the billing date shown on the billing statement on which the charge was first billed to Buyer.
3. The balance subject to finance charge ("Finance Balance") shown on a billing statement will consist of charges, including finance charge incurred month(s) or more before the billing date shown on the billing statement less payments or credits received by Seller by said billing date.
4. On each billing statement on which a Finance Balance appears, a **FINANCE CHARGE** will be imposed on the Finance Balance at the periodic rate(s) of % per month (**ANNUAL PERCENTAGE RATE** of %) for the Finance Balance up to $ and % per month (**ANNUAL PERCENTAGE RATE** of %) of any excess, subject to a minimum **FINANCE CHARGE** of $ per month.
5. Seller may at any time amend any of the terms of this agreement upon written notice mailed or delivered to Buyer in accordance with applicable law, and any amendment may apply to balances then outstanding. Seller may limit or terminate Buyer's right to use the Account without prior notice.
6. If any amount due and payable under this agreement is referred for collection to an attorney not a salaried employee of Seller, Buyer will be charged and agrees to pay reasonable attorney's fees and costs not exceeding the maximum amount permitted by applicable law.
7. Seller hereby waives any security interest in or lien (other than judgment lien) upon any real property used as a principal residence of Buyer, unless expressly reserved in writing at the time of sale.
8. The law of the State where Buyer resides shall govern this agreement.

NOTICE TO THE BUYER

1. DO NOT SIGN THIS CREDIT AGREEMENT BEFORE YOU READ IT OR IF IT CONTAINS ANY BLANK SPACES.
2. YOU ARE ENTITLED TO A COMPLETELY FILLED IN COPY OF THIS CREDIT AGREEMENT.
3. YOU MAY AT ANY TIME PAY YOUR TOTAL INDEBTEDNESS UNDER THIS AGREEMENT.
4. NOTICE: SEE ACCOMPANYING STATEMENT FOR IMPORTANT INFORMATION REGARDING YOUR RIGHTS TO DISPUTE BILLING ERRORS.

Date _____

_____
(Authorized Signature)

_____
(Store Name)

_____
(Store Street Address)

_____
(Store City and State)

_____
(Store Phone Number)

BUYER ACKNOWLEDGES RECEIPT OF THE ATTACHED COPY OF THIS CREDIT AGREEMENT AND THE ACCOMPANYING STATEMENT REGARDING BUYER'S RIGHTS TO DISPUTE BILLING ERRORS.

_____
(Signature of Buyer)

_____
(Buyer's Street Address)

_____
(Buyer's City and State)

Form No. 941
8/23/77

DIRECT INQUIRIES ABOUT YOUR ACCOUNT TO THE STORE'S ADDRESS INDICATED ABOVE.

WHITE COPY ORIGINAL COPY YELLOW COPY CUSTOMER COPY

Credit Limits

The real important question for a retailer generally is not whether to grant credit to an individual customer but rather how much credit to grant. When credit is granted through a credit card, these questions, of course, do not come up. They are only applicable if the retailer grants the credit directly and therefore carries the risk of losses if the purchaser does not pay.

For this reason, retailers who establish credit accounts for customers obtain information on those customers and check their payment performance in order to decide how much credit to grant.

This may be done in any number of ways:

- Many retailers make use of credit bureaus*which provide financial information about individuals and how they pay their bills. Since such inquiries cost money, retailers who do make use of them, use them judiciously - primarily when large amounts of credit are involved.

- Some retailers, in granting direct credit, will do so only if the individual customer has a major credit card. Here the retailer assumes that an individual must be a good credit risk if a major credit card company approved the individual for credit.

- In extreme cases, or sometimes with very young people, retailers may ask for endorsers, usually the parent. In this way, the endorser is held responsible for the bill if the individual is unable to pay.

- Another variation of reducing the risk could be to insist on a substantial down payment for a large purchase.

- In deciding on credit limits, some banks, credit organizations and large retailers use a point system where they give the maximum number of points for owning a home in the community, some points for a bank account, some points for length of time on the job, and some points for the level of income. All these points, when added together would then determine the amount of credit an individual would be granted.

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*See footnote on page 19.

Once credit has been granted, the customer is informed of the amount and type of credit granted, and the conditions, if any. The information about finance charges is then again provided to assure fair and adequate notice.

11. *What are some of the characteristics of a customer which would be checked when deciding how much credit to grant?*

    Your Answer:

12. *If you were deciding on revolving credit in your business where people are buying regularly but where individual purchases are rarely more than $100, how much credit would you allow the following two people?*

    A. *Female applicant: 12 years at the present address; employed for 18 years; current annual income $12,000; local checking account and local savings account. She owns a small home estimated at $30,000 with a $10,000 mortgage remaining.*

    B. *Male applicant: 9 months at current address; 3½ years at previous address; current annual income is $10,000; local savings and checking accounts. He rents an apartment for $200.00 a month. He has an open balance of $600.00, a personal loan with a bank and makes monthly payments of $30.00*

    Your Answer:

Procedures for Authorizing Credit Purchases

Every retailer, no matter how small, should have a policy for authorizing credit purchases. This is even true when credit purchases are always charged on credit cards. That policy should be clearly known to all employees. It should include:

1. The procedures required by credit card companies such as:

   - checking the book to see whether the credit card is valid
   - checking for authorization whenever large purchases require such checking
   - writing the authorization number onto the credit slip, and
   - verifying the signature on the credit slip with the one on the card

2. If credit is direct, the procedure should specify how much credit can be granted to an individual with approval from the owner and what steps are required to assure that an individual does not exceed that limit.

13. What steps should be in the procedure for authorizing credit purchases when a credit card is involved?

Your Answer:

14. What steps should be in the authorization procedure for purchases if credit is given directly?

Your Answer:

Book Answer

11. Some of the characteristics of a customer, which might be checked in deciding how much credit to grant, are:

- *the customer's current position and his or her previous position if the time spent in the current position was relatively short*
- *the customer's salary and other income*
- *rent and mortgage payments and whether the customer rents or owns*
- *the customer's major financial obligations*
- *credit references including, usually, at least one bank and one other credit line; either credit card or other charge accounts*
- *number of dependents*

ON-THE-JOB ACTIVITY 2

Prepare a checklist for employees which will assure that all purchases on credit satisfy the policy. This should include the statement of the basic policy as well as all the steps involved in a credit purchase and the records that are to be kept.

If possible, discuss your thoughts with a person whose opinion you respect and see what additional ideas come from such a discussion.

AVOIDING LOSSES IN CONSUMER CREDIT

There are three important aspects to avoiding losses in granting direct consumer credit and these involve:

- a credit and collection policy - stated, communicated and followed
- detailed records and a regular review of the credit status
- a thorough collection procedure

Good Records

For the purpose of reviewing customer accounts and the total credit picture, accurate records are essential. One good system of keeping track of credit purchases is to use a notebook, with one page to a customer. On each page could be recorded:

- the customer's name
- address
- the maximum amount of credit allowed to the customer
- the date an item was purchased
- the item which was purchased
- the amount of purchase
- the payments received and the outstanding balance

Such a system is simple and easy to maintain and can provide you with accurate information concerning the amount of money your customers owe you. An example of a page out of such a notebook of credit records is on page 27.

Book Answer

12. *Although there are no definite answers as to exactly how much credit to lend the people in these two situations, some possible responses are provided below:*

    A. *The female applicant seems to be financially secure and therefore is probably a good credit risk. You might wish to extend her $200.00 - $300.00 worth of credit.*

    B. *The male applicant looks fairly transient or unstable in terms of his career. All his other financial obligations seem to place quite a drain on his finances. It would probably be best to be very cautious about granting credit to this fellow. You might possibly extend him $100.00 of credit, but only if he can provide you with a substantial down payment. It might be worth it to check with a credit bureau to see how this fellow pays back money he borrows.*

Book Answer

13. *The procedure for authorizing credit purchases when a credit card is involved should be known to all employees and should include the following steps:*

    - *checking the book to see whether the credit card is valid*
    - *checking for authorization whenever the purchase exceeds the store's authorization line and writing the authorization number onto the credit slip*
    - *verifying the signature on the credit slip with the one on the credit card*

An Example of a Customer Account Record

Name: Ms. Irma Wanderbody Maximum: $50.00

Address: 873 Vine Street, S.P.

Date	Item	Purchase	Payments	Balance
3/16/77	G.E. Toaster Oven	$30.00		$30.00
4/1/77			$30.00	---
4/5/77	Paint and 3 brushes	$15.00	---	$15.00
4/9/77	Wallpaper, 3 rolls #5XB	$30.00	---	$45.00
4/12/77			$15.00	$30.00
5/1/77	Clock Radio #XIX-FM AM	$17.00	---	$47.00

From a business point of view, it is wise to lay out a monthly reporting form that shows either the number of accounts that are 30 days unpaid, or the dollar amount unpaid, or the percentage of total credit volume that is on such unpaid overdue credit. Some retailers maintain all three figures on a month-to-month basis (An example of a monthly reporting form is presented on page 28.)

Book Answer

14. The procedure for authorizing credit purchases where direct credit is involved should include the following steps:

- *specification of how much credit can be granted to an individual without approval from the store owner*
- *the procedure required to assure that an individual does not exceed that limit*
- *communicating the credit policy clearly to all employees*

At least once each month you should also obtain information on how much you have had to write off as bad debt losses. Such losses should include payments to attorneys and collection agencies for their work in relation to collections.

An Example of a Monthly Reporting Form

Month	New Credit Issued	Repay-ments	Out-standing Balance	Balance over 30 days and less than 60 days	Balances 60 days or more
Mar.	800	850	200	150	50
Apr.	634	500	334	205	29
May	750	600	405	285	120
June	400	350	305	250	55

As you can see in this example, the first line indicates that in March, a particular retailer issued $800.00 in credit and, during the month, received $850.00 in payment; there remained $150 in unpaid bills in the 30-60 day column and $50 in the 60 day category. The next line down indicates that in April the retailer lent $634.00 in credit but only received $500 back in payment. This increased the overdue amount to $334.00. The picture became even worse in May when more credit slipped into the 60 day column. June then began to improve somewhat, probably due to more vigorous collection efforts.

ON-THE-JOB ACTIVITY 3

If you do not already have one, lay out a form that would provide you with the information on a month-to-month basis that you believe you need for follow-up on outstanding balances. If you have a form, review it to see whether you consider it adequate. You may wish to use a modification of the form provided in the example on page 28.

If possible, discuss your thoughts with a person whose opinion you respect and see what additional ideas come from such a discussion.

COLLECTION PROCEDURE

The procedure outlined below is one you could use or modify to suit your situation:

1. Once a month review any outstanding balances that are more than 30 days old to see what problems might exist.

2. Follow up any bill not paid within 30 days. Send a statement to the customer to inform him or her of the overdue amount. Indicate that finance charges have begun and the rate at which they are being charged. (See example statements on page 30.)

3. For all accounts which are more than 30 days overdue, send a personal letter with the statement which asks the customer whether he or she has overlooked the bill and whether there is any problem. You could also ask the customer to please come in and discuss any problems that may exist. (See example collection letter on page 31.)

4. Once a bill is 90 days old, more forceful collection activities are essential. Make a personal phone call either at the 60 day point or no later than the 90 day point. If the customer still does not pay, send a strong letter, preferably over a lawyer's signature or on a lawyer's letterhead, indicating that legal action will have to be taken if payment is not made. (See the example forceful letter on page 33.)

   Obviously, great care should be taken before credit is granted again to anyone who has reached this last step.

The following are some examples of reminders sent to customers who have not paid their bills within 30 days. These reminders may be cards or a brief mimeographed form letter.

REMINDER OF PAST DUE BILLS

Our records show that your balance for the amount of:_____ is now past due. Please give this your prompt attention. (Finance charges on overdue accounts are at the rate of 2% per month.)

If payment has been made by the time this reaches you, please disregard this reminder and accept our thanks.

Le Roy's Clothing

Colonial Sporting Goods

Dear:

If you have already paid the past due amount due of $68.31 please disregard this notice. Your payment may have arrived after we started making out your bill; in that case,your account will have been brought up to date by now, and your payment already recorded.

If you have not sent payment, please do so promptly since your account is now overdue and interest charges are accruing at the rate of 2% per month.

Please let me know if there is a problem with which I may be able to help.

Sincerely,

Manager

A Sample Letter for Collecting Payments Over 30 Days Due

Ms. Jones:

Is there some reason you have been ignoring our bill? (The details about it are given below.)

If there is, we certainly would like to know about it.

But if there isn't, please be kind enough to honor it at this time since it is now way overdue.

We would appreciate word from you - or your check - by return mail.

Thank you.

Sincerely yours,

H. R. Stern
Accounts Receivable

YOUR PURCHASE ORDER NO:

INVOICE NO:

DATED:

AMOUNT:

- - - - - -

15. *What steps do you believe should be taken to assure that collection is handled effectively?*

Your Answer:

Book Answer

15. *Some steps which might be taken to assure that collection is handled effectively are:*

- *regular reviews of outstanding balances*
- *keeping accurate credit records on each credit customer*
- *laying out monthly reporting forms which show the amount of overdue credit*
- *maintaing a good credit policy and communicating this policy to all store employees*
- *having a good credit collection procedure*
- *sending reminders out to customers for any bill not paid within 30 days*
- *sending a personal collection letter to customers with accounts which are more than 30 days overdue*
- *making personal phone calls to the customers who have accounts 60 days overdue or sending a strong letter, preferably over a lawyer's signature or on a lawyer's letterhead, indicating that legal action will have to be taken if payment is not made*
- *being very cautious about granting credit again to any customers who have had accounts 90 days overdue or longer*

A Sample Letter for Collecting Payments Over 90 Days Due

GEMPOINT JEWLERS

March 8, 1978

Mr. George Walker
121 Broad Street
Easton, Pa.

Dear Mr. Walker:

Despite repeated telephone calls and monthly statements to you, your balance of $73.51 remains as yet unpaid, according to our records. The amount is not very large, but it is an inconvenience to carry it on the books from month to month.

The balance is now three months past due. We would appreciate it very much if you would arrange to have it paid so that we can close our files for your purchases.

Our usual policy is to refer such old unpaid balances to a collection agency for collection. However, we would prefer not to resort to such measures unless we have no other alternative.

Please let us hear from you soon.

Sincerely,

hg
Enclosure

SUMMARY REVIEW/CHECKLIST OF CREDIT POLICY

For Credit Cards or Direct Credit----------

_____ Put in writing a policy that discusses the objectives and the major features of the way credit is granted.

_____ Establish clear-cut procedures for authorizing customer purchases, that give the amount that can be allowed and the procedures for recording all the necessary information.

_____ Evaluate at least once a year, the benefits and costs of credit including a review of alternatives that could be used to reduce the total cost of granting credit.

For Direct Credit Only ----------

_____ Provide a fairly clear-cut procedure, using credit points, for establishing credit limits for each individual.

_____ Adhere to these credit limits with respect to individual customers.

_____ Change credit limits based on the experience with customer payment practices.

_____ Develop a report that allows easy review of outstanding balances at least once a month.

_____ Establish and adhere to a clear procedure for following up on late payments.

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